

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION TO TRANSFER LICENSES)
TO CARDINAL UTILITIES, INC.) CASE NO. 9480

O R D E R

On December 12, 1985, Cardinal Utilities, Inc., ("Cardinal") applied for authority to operate six sewage treatment facilities formerly owned by Red Wing Utility Company, Inc. ("Red Wing"), and a public hearing was held on December 19, 1985, at the Commission's offices.

COMMENTARY

The six sewage treatment facilities acquired by Cardinal are known as: Green Acres, Blandville West Estates and Fieldmont Estates, in McCracken County; Golden Acres and Gateway, in Marshall County; and Holifield Heights, in Graves, County. According to Red Wing's Annual Report for the year ended December 31, 1980, the most recent report including separate operating statistics for each treatment facility, these sewage treatment facilities serve 225 residential and commercial customers and have a treatment capacity of 140,000 gallons per day.

The six facilities were purchased on November 15, 1985, by Mrs. Larraine P. Kimbrell at a public sale ordered by the United States District Court, Western District of Kentucky, Paducah Division, in the foreclosure action First Liberty Bank v. Public

Service Commission et al, Defendants, Civil Action No. C-84-0326-P(J), entered October 11, 1985. The total price for all six was \$20,100. Cardinal was incorporated on November 25, 1985, by Mrs. Kimbrell to acquire and operate these facilities.

In Case No. 7568,¹ the Commission found that Red Wing had not managed its sewage systems in an efficient, prudent and reasonable manner. The Commission questioned the reliability of financial data presented by Red Wing, the basis for allocating operating expenses common to Red Wing and an affiliate and determined that Red Wing had not complied with statutory requirements for a certificate of public convenience and necessity authorizing new construction and for approval of new debt and equity financing. Since the new owner has the ability to improve the operation of the utilities and has vowed to do so, the Commission has determined that the transfer is in the best interests of the customers.

The record shows that Cardinal intends to operate the six systems as a single corporate entity, and for reasons of economy and efficiency that employees of other commonly-owned, non-utility enterprises may be used part time. The owners have been made aware of the potential accounting difficulties that may

¹ Final Order dated October 31, 1980, Case No. 7568, Application of Red Wing Utility Company, Inc., for an Increase in Rates for the Sewage Treatment Facilities Located in: Gateway Subdivision, Marshall County; Golden Acres Subdivision, Marshall County; Blandville Estates, McCracken County; Green Acres Subdivision, McCracken County; Fieldmont Estate, McCracken County; Holifield Estates, Graves County.

arise from commingling of assets and expenses of regulated and non-regulated enterprises (and between regulated systems), and have agreed to keep each system's accounts separate, as required by the Uniform System of Accounts for Sewer Utilities and Commission regulation 807 KAR 5:006.

The Commission considers these plans reasonable, at least for a limited time, in order to determine if the cost of operation varies substantially among the six facilities. However, this manner of operation will require Cardinal to maintain further detailed records in order to assure the proper allocation of expenses common to each facility.

Cardinal should file with the Commission, no later than 120 days from the date of this Order, a plan detailing the manner in which it proposes to allocate the expenses. To facilitate the record keeping and allocation requirements, the Commission suggests that Cardinal consider a written operating or service agreement establishing the basis for expense allocation. The Commission staff is available to assist with the details of such an agreement if Cardinal should need assistance in designing an arrangement that would be acceptable for accounting purposes.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. Cardinal is ready, willing and able to operate and provide adequate and reliable service to the customers presently served by Red Wing.

2. Cardinal has issued Mrs. Lorraine Kimbrell 201 shares of no-par common stock in exchange for her cash investment of \$20,100 used to purchase the six systems.

3. Cardinal has adopted the tariffs, rates, rules and regulations filed with the Commission by Red Wing for furnishing sanitary sewer service to its customers and that these are the only rates, rules and regulations approved by the Commission.

4. A third party beneficiary agreement for these sewage treatment facilities has not been entered into but sufficient evidence of financial integrity has been shown by alternative means in that a sufficient letter of credit has been established.

5. Cardinal has filed with the Commission its Articles of Incorporation and Certificate of Incorporation.

6. Cardinal should maintain its books of account in accordance with the Uniform System of Accounts for Sewer Utilities prescribed by this Commission. Accounting for an acquisition includes:

- a. Recording the utility plant acquired at its original cost to the person first devoting it to public service, estimated if not known, in the appropriate utility plant in service accounts;
- b. Crediting the requirements for accumulated provision for depreciation and amortization applicable to the original cost of the properties acquired to the appropriate account for accumulated provision for depreciation and amortization;
- c. Transferring the cost of any nonutility property to Account 121, Nonutility Property;
- d. Crediting contributions in aid of construction to Account 271, Contributions in Aid of Construction; and
- e. Including in Account 108, Utility Plant Acquisition Adjustment, any difference between the purchase price

and the original cost of the utility plant and non-utility property less the amounts credited to accumulated depreciation and amortization reserves and contributions in aid of construction.

7. While legal and proper for general accounting purposes, an acquisition transaction, if not at "book value," can either increase or decrease the debt and/or equity on the utility's books. In this case, the purchase price is less than net book value; therefore a "bargain purchase" has occurred. The negative acquisition adjustment that has resulted will not increase the plant value for rate-making purposes. It is the ✓ Commission's opinion that a bargain purchase is in effect a contribution and should be passed on to the utility's ratepayers.

8. Cardinal should file a plan detailing the manner in which it proposes to account for the operations of the utility, including the allocation of expenses, within 120 days from the date of this Order.

9. The transfer of the assets should be approved since Cardinal is ready, willing and able to operate the sewage treatment facilities.

IT IS THEREFORE ORDERED that:

1. The transfer of assets to Cardinal be and it hereby is approved.

2. Cardinal shall account for this transfer in accordance with the Uniform System of Accounts for Sewer Utilities prescribed by this Commission as described in Finding No. 6.

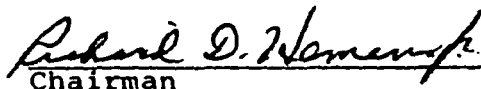
3. Cardinal shall file a plan detailing the manner in which it proposes to account for the operations of the utility,

including the allocation of expenses, within 120 days of the date of this Order.

4. Cardinal shall file with this Commission within 30 days of the date of this Order its original tariff sheets setting forth its rates, rules and regulations as required by KRS 278.160.

Done at Frankfort, Kentucky, this 14th day of March, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary